

INVESTMENT POLICY FOR THE STATE OF ILLINOIS EMPLOYEES' DEFERRED COMPENSATION PLAN

Mission Statement

Pursuant to Article 5/24 of the Illinois Pension Code, the Illinois State Board of Investment (the "Board") is responsible for developing and establishing a deferred compensation plan for employees¹ of the State which shall be known as the State Employees Deferred Compensation Plan (the "Plan"). In recognition of the Board's role as the named fiduciary to the Plan, the Board has adopted the following Mission Statement:

The Plan Mission Statement

It is the mission of the Plan to allow employees to designate a portion of their compensation² to be withheld by the State of Illinois and invested in a manner approved by the Board as a voluntary method of accumulating long-term savings to supplement their retirement income or bridge income between jobs.

Statement of Purpose of Investment Policy

The purpose of this investment policy (the "Policy") is to formalize the Board's investment objectives, policies and procedures with regard to the assets of the the Plan. This Policy may be modified, in whole or in part, by the Board at any point in time.

It is the intention of the Board that the assets of the Plan shall be maintained in compliance with all applicable laws and administrative rules governing the operation of the Plan. In effecting the Policy, all fiduciaries shall perform their duties with respect to the Plan with the care, skill and diligence that would be applied by a prudent person, acting in a like capacity and with like aims for the sole interest of Plan participants and beneficiaries.

Distinction of Responsibilities

The Board, with the input of its Staff and an independent investment consultant ("Consultant"), is responsible for the selection of the investment options of the Plan. Plan participants are responsible for the allocation of their assets among the investment options of the Plan. Investment managers are responsible for selecting individual investments and constructing portfolios to meet the investment option's performance objectives.

Investment Objectives

The objective of the Board is to offer a sufficient range of investment options to allow Plan participants to diversify their account balances and construct portfolios that reasonably span the risk/return spectrum.

In that regard, the Plan's investment structure shall follow the guidelines listed below:

Type of Option	Number of Options
Money Market ³	0-1
Stable Value	0-1

¹ For purposes of this Policy, the term "employee" has the same meaning as set forth under the Illinois Pension Code (40 Ill. Comp. Stat. § 5/24-102).

² For purposes of this Policy, the term "compensation" has the same meaning as set forth under the Illinois Pension Code (40 Ill. Comp. Stat. § 5/24-102).

³ The Plan must offer at least one investment option among the Money Market and Stable Value type.

Core Bond	1-2
Core Bond Index	1
Balanced/Asset Allocation	0-1
U.S. Stock:	
Large Value	1
Large Core Index	1
Large Growth	1
Mid/Small Value	1-2
Mid Core Index	1
Small Core Index	1
Mid/Small Growth	1-2
Non-U.S. Stock	1-3
Non-U.S. Stock Index	1
Target Retirement Date Funds	8-12
TOTAL	19-31

The Board will also make best efforts to include representation of emerging investment managers⁴ and minority investment managers⁵ in the Plan. The Plan will seek to include at least one investment option managed by a State of Illinois certified⁶ minority investment manager, unless the Board determines that no such entity exists that conforms to the Board's fiduciary responsibility.

The Board will select investment options after satisfactory review of factors such as the investment experience of the underlying manager, the suitability of the investment approach used and the investment record.

Selecting Investment Options

The combination of investment options will be consistent with the goals and investment structure outlined in this Policy. This allows the Plan participant to select investment options to construct an efficient portfolio, thereby reducing the independent risk of any one asset class.

The criteria used in selecting investment options is based on the combination of several factors. For consideration by the Plan, an investment option must meet the defined standards or mandatory minimum thresholds as listed. The criteria for investment options designed to approximate the return of a specific index are, in some cases, different from those of actively managed products as outlined below. The criteria for suitable investment options within the structure are:

1. The investment option has consistently adhered to clearly defined investment objectives.
2. The investment option has demonstrated investment results that consistently rank it in the upper median of those investment options with similar objectives.
3. The investment option has performed favorably in difficult market environments relative to its peers.

⁴ The term "emerging investment manager" is set forth under the Illinois Pension Code and is defined as "a qualified investment adviser that manages an investment portfolio of at least \$10,000,000 but less than \$10,000,000,000 and is a 'minority owned business', 'female owned business' or 'business owned by a person with a disability' as those terms are defined in the Business Enterprise for Minorities, Females, and Persons with Disabilities Act." (Ill. Comp. Stat. § 5/1-109(4)).

⁵ ⁵ For purposes of this Policy, the term "minority investment manager" includes emerging investment managers and/or minority owned business, female owned business, or business owned by a person with a disability as those terms are defined in the Business Enterprise for Minorities, Females, and Persons with Disabilities Act.

⁶ A "State of Illinois certification" is a certification granted by the Illinois Department of Central Management Services to a Minority Business Enterprise, a Female Business Enterprise or a Person with Disabilities Enterprise under the Business Enterprise Program for Minorities, Females, and Persons with Disabilities.

4. The alpha, beta, R-squared, standard deviation, and a risk/reward analysis of the investment option are favorable and commensurate with the stated investment objectives of the Plan.
5. The expense ratio of the investment option is reasonable relative to investment options with similar objectives.
6. The investment option is an appropriate size to accommodate assets of the Plan.
7. The investment option sponsor or family of investment options has demonstrated over time that their depth of operation and management is superior. The future outlook of the investment option is positive considering the investment manager, portfolio structure, and investment style.
8. The investment option must be willing, pursuant to contract between the Board, on behalf of the Plan, and the investment option, to meet specified requirements, including the obligation to meet with Board Staff and Consultant once a year for a summary review of the performance of the investment option.

Performance Expectations

Investment options that are actively managed are expected to exceed their respective performance benchmarks net of fees, over a three to five year market cycle, and rank above the median peer group universe. Investment options that are passively managed are expected to track their respective performance benchmarks.

Risk Tolerance

The Board recognizes the uncertainty of achieving the stated investment objectives in light of the volatility and complexities of contemporary investment markets. The Board also recognizes that the selection of each investment option involves the assumption of some risk in order to achieve its long-term investment objectives. Each investment option should be selected with a strong consideration to risk and reward over time.

Securities Guidelines

The Board will review each investment option selected and expect the investment option to adhere to the terms as defined within this Policy as well as any negotiated contract between the Board, on behalf of the Plan, and the investment option. The Board will review investment information pertaining to the Plan's investment options on an ongoing basis.

Ongoing Evaluation

Consultant, as selected by the Board, is responsible for performing a thorough due diligence on each investment option. Consultant will monitor the performance of the Plan's investment portfolio on an ongoing basis and provide a quarterly report to the Board, addressing the performance of each investment option relative to the appropriate index and similar portfolios in a universe of same style investment options and recommendations for change, as warranted. All of the criteria that was considered by the Board in the investment option selection process will also be reviewed on a quarterly basis.

Watch List Procedures

A "Watch List" is utilized for investment options that fail to meet expectations. An investment option may be placed on the "Watch List" for any of the following reasons:

1. Poor performance relative to assigned benchmark;
2. Excessive risk relative to assigned benchmark as measured by standard deviation;
3. Portfolio rank below median versus peer group;
4. Style drift versus assigned benchmark;

5. Change in the investment management style for which the investment option was retained;
6. Sub-optimal investment risk characteristics including Alpha, Beta, Sharpe ratio, Information ratio, and tracking error relative to assigned benchmark;
7. Key investment professional turnover;
8. Organizational issues or any ownership change;
9. Excessive out-flows from the firm or product;
10. Violation of any ISBI statutory or contractual requirements;
11. Any other material irregularities where notification to the Board is necessary; or
12. Three year annualized benchmark return exceeds the return of the investment option.

Board Staff and/or Consultant make a “Watch List” notification to the Board for an investment option based on the above factors, using their discretion. The “Watch List” will be located in the Consultant’s quarterly report.

After notifying the Board of the “Watch List” status, Board Staff promptly notifies the investment option of the status verbally and/or in writing. Unless directed by the Board to the contrary, Board Staff shall invite the investment option to appear at the next regularly scheduled meeting of the Board.

Depending on the infraction, the investment option remains on the “Watch List” for a minimum of one quarter to a maximum of one year before further action is taken.

The “Watch List” statuses are set forth below:

“On Notice” - If Board Staff and/or Consultant remain concerned with one or more of the investment options based upon the “Watch List” factors, Board Staff and/or Consultant may place the investment option “On Notice.” The investment option’s failure to improve the “Watch List” factor(s) at issue within a specific time frame (depending on the infraction) justifies a termination recommendation by Board Staff and/or Consultant to the Board. If the investment option is placed “On Notice”, Board Staff promptly notifies the investment option verbally and/or in writing. During the “On Notice” designation period, Board Staff and/or Consultant formulate a recommendation regarding the investment option and the asset class for the Board’s review.

“Termination” - If the Board votes to terminate the investment option, Board Staff promptly notifies the investment option in writing and begins coordinating the procedures for investment option replacement or dismissal as outlined below.

“In-Compliance” - If the investment option resolves the issues bringing rise to the “On Notice” designation the investment option will be reclassified as “In-Compliance,” upon the decision of Board Staff and/or Consultant.

The aforementioned Watch List procedures serves as a guideline for Plan participants, the Board, its Staff, and Consultant. The Board, as the named fiduciary to the Plan, has discretion to change or deviate from the Watch List procedures at any time as circumstances dictate.

Procedures for Investment Option Replacement or Dismissal

Once the Board has made the final decision to terminate an investment option, the investment option cannot remain in the Plan for longer than one year. The following procedures outline the process for investment option replacement or dismissal:

1. Notice will be given to the investment option of termination with a timeline for divestiture.
2. A date will be selected to freeze any new deferrals or transfers into the investment option, if applicable.
3. Participants will be given notice of the closure, effective dates, and a time period no shorter than 30 days but not to exceed one year for transferring out to the new investment option.

4. Any share in the terminated investment option at the end of the designated time frame will be liquidated and transferred to the investment option with most similar risk/return characteristics and performance objectives. If no similar investment option is available then a diversified balanced fund investment option in the Plan shall serve as the default.
5. Notice will be sent to participants affected by the liquidation.

Summary

The Plan is a long-term retirement savings program and the guidelines set forth in this Policy must consider a consistency of performance compared to set benchmarks and peer groups over the longer term rather than relying on an occasional exceptional year or short period of poor performance. Therefore, emphasis is placed on the long-term objectives of the investment options. Interim performance reviews are conducted to continually monitor the investment options to detect any significant changes or irregular progression that may prove to be outside the realm of the occasional short-term underperformance.

Exceptions

Any changes to this Policy must be made in writing and approved by the Board.

Adopted: March 24, 2006
Amended: June 30, 2006
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